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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. [redacted]

[redacted]

v.

[redacted]

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE [redacted] CIRCUIT

[redacted]

INDEX

	PAGE
Opinion Below	2
Jurisdiction	2
Questions Presented	2
Statute Involved	4
Statement	4
Specification of Errors to Be Urged	11
Reasons for Granting the Writ	12
Conclusion	21
Appendix	22

CASES

American United Mutual Life Ins. Co. v. City of Avon Park, 311 U. S. 138 13

Berner v. Equitable Office Building, 175 F. 2d 218 ..... 17, 18, 19

Brooklyn Trust Co. v. Kelby, 134 F. 2d 105, cert. denied, 319 U. S. 767 6

Brown v. Gerdes, 321 U. S. 178 20

Central Hanover B. & T. Co. v. President and Directors of the Manhattan Co., 105 F. 2d 130 6

City Bank Farmers Trust Co. v. Cannon, 291 N. Y. 125 17

Dickinson Industrial Site, Inc. v. Cowan, 309 U. S. 382 20

Eddy v. Kelby, 319 U. S. 755 6

Eddy v. Kelby, 163 F. 2d 56, cert. denied, 332 U. S. 836 6

Eddy v. Kelsey, 148 F. 2d 323 6

Eddy v. Prudence-Bonds Corporation, 165 F. 2d 157, cert. denied, 333 U. S. 845 ..... 6, 7, 8, 16

Equitable Office Building, In re, U. S. D. C., S. D. N. Y., Jan. 10, 1950, Knox, J., not officially reported 18

PAGE

Manufacturers Trust Co. v. Kelby, 125 F. 2d 650, cert. denied, 316 U. S. 697 6

Meinhard v. Salmon, 249 N. Y. 458 ..... 13, 14

Midland United Co., In re, 64 F. Supp. 399, aff'd 159 F. 2d 340 ..... 18, 20, 21

Munson et al. v. S. G. & C. R. R. Co., 103 N. Y. 58 17

Presbyterian Church v. Plainfield Trust Co., 139 N. J. Eq. 501 17

President and Directors of the Manhattan Co. v. Kelby, 57 F. Supp. 839, modified and affirmed, 147 F. 2d 465, cert. denied, 324 U. S. 866 6

Prudence-Bonds Corporation, In re, 76 F. Supp. 643 6

Silbiger v. Prudence-Bonds Corporation, No. 546, October Term, 1949, not officially reported 10

Teasdale v. Sefton Nat. Fibre Can Co., 85 F. 2d 379 20

Trustees v. Greenough, 105 U. S. 527 21

United States v. Costen, 38 Fed. 24 19

Weil v. Neary, 278 U. S. 160 17

Wendt v. Fisher, 243 N. Y. 439 17

Woods v. City National Bank, 312 U. S. 262 ..... 13, 14, 18

Young v. Highbee Co., 324 U. S. 204 20

Young v. Potts, 161 F. 2d 597 20

STATUTES

Bankruptcy Act:

Sec. 24(c), 11 U. S. C. Sec. 47(c) 2

Sec. 210, 11 U. S. C. Sec. 610 ..... 11, 22

Sec. 249, 11 U. S. C. Sec. 649 ..... 18, 20, 21, 22

Judicial Code:

Sec. 240(a), 28 U. S. C. Sec. 347(a) 2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. .....

PRUDENCE-BONDS CORPORATION (New Corporation),
Petitioner,

v.

SAMUEL SILBIGER, et al.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner, Prudence-Bonds Corporation (New Corporation), respectfully prays that a writ of certiorari issue to review the decree of the United States Court of Appeals for the Second Circuit entered in the above cause on March 7, 1950, modifying an allowance awarded to Samuel Silbiger, Esq., and affirming allowances awarded to Arthur Miller, Esq. and Weil, Gotshal & Manges, Esqs. for services in the proceeding for reorganization of Prudence-Bonds Corporation, Debtor, under Section 77B of the Bankruptcy Act (R. 755, 765). Petitioner's appeal to the Court below was taken by leave of the Court and "limited to the question of conflict of interest represented" (R. 7).

Opinion Below

The opinion of the Court of Appeals for the Second Circuit dated March 7, 1950 (R. 755) is not yet reported.

Jurisdiction

The decree of the Court of Appeals, Second Circuit, was entered on March 7, 1950 (R. 765). Petitions for rehearing filed in that Court by petitioner (R. 766) and by Samuel Silbiger. Esq. (R. 779) were denied on April 5, 1950 (R. 786), although the Court, on the said petition of petitioner, amended its opinion (R. 785).

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended, 28 U. S. C. 347(a), and Section 24(c) of the Bankruptcy Act, as amended, 11 U. S. C. Sec. 47(c).

Questions Presented

In a corporate reorganization under the Bankruptcy Act, a proceeding (called for convenience the "Construction Proceeding") was had to construe a confirmed Plan of Reorganization, and involved, in part, a controversy over priorities among two classes of bondholders, one class being called "Surplus Series", the other "Deficit Series". Two differing situations necessitate division of the questions into two categories.

I

Samuel Silbiger, Esq., an attorney at law, represented bondholders of both Surplus and Deficit Series. Without consent of his clients or court authorization, Mr. Silbiger advocated in the Construction Proceeding the interests of his Surplus Series clients and opposed the interests of his

Deficit Series clients. The Surplus Series won the controversy on an appeal prosecuted by Mr. Silbiger and others. Mr. Silbiger was awarded an allowance of $75,000 payable by the Surplus Series. On appeal by petitioner and Reconstruction Finance Corporation, the Court below held that Mr. Silbiger represented conflicting interests and was disloyal to one of the interests, but, confessing to a departure from the established "rule of undivided loyalty", which requires denial of all compensation to an attorney serving conflicting interests, held that he may nevertheless have an allowance on a reduced basis on the ground "there is a distinction between a corporate reorganization and an ordinary suit *inter partes*" (R. 760).

The questions presented regarding Mr. Silbiger are:

1. Is the "rule of undivided loyalty" applicable to attorneys at law with the same force and effect in a corporate reorganization proceeding under the Bankruptcy Act as it is in a suit *inter partes?*

2. In applying the "rule of undivided loyalty" can a valid distinction be made between a corporate reorganization proceeding under the Bankruptcy Act and a suit *inter partes* so as to authorize the bankruptcy court to award an allowance to an attorney serving conflicting interests, payable by the interest to whom he was loyal?

3. Is the decision of the Court below a valid exception to the "rule of undivided loyalty" as enunciated in decisions of this Court involving conflicts of interests in bankruptcy cases?

II

Arthur Miller, Esq. and Messrs. Weil, Gotshal & Manges appeared in the Construction Proceeding on behalf of individual clients who bought and sold during the proceeding many large blocks of bonds of both Surplus and Deficit Series. They advocated the side of the Surplus Series;

they did not purport to represent or owe any duty to other bondholders of any class; and they did not file the statement required by Section 210 of the Bankruptcy Act. The Court below affirmed allowances to them aggregating $30,000, payable by the Surplus Series.

The questions presented regarding these awards are:*

4. Does the Bankruptcy Act require denial of any allowance of compensation to attorneys whose clients, during the proceeding in respect of which the services were rendered, actively traded in the securities of the corporation in reorganization?

5. In a contest in a corporate reorganization over priorities among classes of security holders are the interests of individuals who actively trade in the securities of the different classes in conflict with the interests of the classes, and, if so, does the Bankruptcy Act require denial of allowances to attorneys who appear only for such individuals and disclaim any duty to any class?

Statute Involved

The pertinent provisions of the Bankruptcy Act, as amended, are set forth in the Appendix, infra, p. 22.

Statement

When the Debtor went into reorganization it had outstanding eighteen Series of bonds aggregating approxi-

* The Court below held that there might be a right of subrogation against the clients of Mr. Miller and Messrs. Weil, Gotshal & Manges, but that it could not determine such question for the reason the clients "are not parties to this proceeding and have not been heard" (R. 764). An additional question which will be urged in the argument on the merits is whether such right of subrogation is not determinable in the proceeding to fix allowances and enforceable by way of reduction of the allowances made.

mately $56,000,000 (R. 212). Each Series was secured by Trust Fund collateral under a Trust Agreement made by the Debtor to a Bank, as Trustee (R. 212). As each Series had separate collateral, some Series were better secured than others (R. 671-672). The bonds of all Series were guaranteed by The Prudence Company, Inc. which itself held $1,910,300 principal amount of the bonds, including some bonds of each Series (R. 212-213).

During the reorganization the Debtor was found to be insolvent (R. 213). The bonds held by the Guarantor were subordinated to the bonds of each Series in the hands of the public (R. 214). The Guarantor itself went into reorganization, was found to be insolvent and was succeeded, under a Plan of Reorganization, by a new corporation named Prudence Realization Corporation, which thereupon became the holder of the subordinated bonds (R. 212).

The Plan of Reorganization of Prudence-Bonds Corporation, consisting of a separate Plan for each bond Series and a General Plan, was confirmed in 1938; the separate Series Plans, except one, were all substantially the same (R. 215). The General Plan provided for a new corporation, also named Prudence-Bonds Corporation (petitioner here), to be owned by the bondholders; the separate Series Plans for an extension of the maturity of the bonds and changes in interest provisions (R. 119, 215). Eleven Banks had been Trustees of the bond Series (R. 120). Under the Plan, one Bank became Trustee of all Series under a Supplemental Trust Agreement with petitioner (R. 215). Upon confirmation, jurisdiction was reserved to carry out the Plan (R. 215).

As part of the proceedings to carry out the Plan, the bankruptcy court, among other things, authorized and directed the former Bank Trustees of the bond Series to account in the reorganization court for their acts as Trustees (R. 217). There then ensued extensive litigation relating to the accounts which has been the subject of sev-

eral decisions of the District Court, the Court of Appeals and several petitions for certiorari.*

The Construction Proceeding, in respect of which the instant allowances were awarded, was instituted in the fall of 1945, following collection of a large judgment against one of the accounting Bank Trustees (R. 121-122).† The questions in the proceeding arose in this way:

The Trust Funds of the Surplus Series had collateral sufficient to pay the principal of the publicly held bonds of the Series and leave an excess in principal account, but the excess was not sufficient to pay the arrears of interest at the original bond rate (R. 562-564, 665). The Trust Funds of the Deficit Series (which constitute the majority of the 18 Series) are insufficient to pay the principal of the publicly held bonds (R. 665). The Plan provided that interest on the bonds was payable at the rate of 5½%, but only to the extent that income on the Trust Fund collateral would suffice, and, in substance, that no payments of principal or interest were to be made on the subordinated bonds until the publicly held bonds of the Series were paid in full (Prior record,‡ pp. 111-113, 164). The

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* *Central Hanover B. & T. Co.* v. *President and Directors of the Manhattan Co.*, 105 F. 2d 130; *Manufacturers Trust Co.* v. *Kelby*, 125 F. 2d 650, cert. denied, 316 U. S. 697; *Brooklyn Trust Co.* v. *Kelby*, 134 F. 2d 105, cert. denied, 319 U. S. 767; *President and Directors of the Manhattan Co.* v. *Kelby*, 57 F. Supp. 839, modified and affirmed, 147 F. 2d 465, cert. denied, 324 U. S. 866; *Eddy* v. *Kelsey*, 148 F. 2d 323; *In re Prudence-Bonds Corporation*, 76 F. Supp. 643; see also *Eddy* v. *Kelby*, 319 U. S. 755, and *Eddy* v. *Kelby*, 163 F. 2d 56, cert. denied, 332 U. S. 836, relating to allowances in the accounting proceedings.

† On the accountings in 15 of the 18 Series of bonds approximately $4,277,100 was recovered for the Trust Funds and allowances for services and expenses in connection therewith were heretofore awarded by the bankruptcy court (R. 227-228). The accountings in two Series are pending.

‡ "Prior record" refers to record on appeal in the Construction Proceeding, *Eddy* v. *Prudence-Bonds Corporation*, 165 F. 2d 157, cert. denied, 333 U. S. 845, which is an exhibit in the instant case, but was not printed since it is on file in the Court below and in this Court.

Plan further provided that upon retirement of all bonds of a Series all collateral remaining in the Trust Fund was distributable, when liquidated, *pro rata* among the other Series then outstanding (Prior record, p. 155; R. 222-223). The purpose of this latter provision was to "enable the less fortunate to be benefited from an excess of collateral of the better issues" (Prior record, pp. 261-262; R. 671-672).

The main question which arose in the Construction Proceeding was how collateral in principal account of a Series in excess of an amount sufficient to pay the principal of the publicly held bonds of the Series was distributable among the three classes of creditors having an interest therein; namely, 1) the publicly held bonds, 2) the subordinated bonds, and 3) the other Series of bonds.* This in turn raised the question: When were the publicly held bonds to be deemed paid in full? Were they paid in full upon payment of principal with income interest only, or were they entitled to unpaid interest at the original bond rate to the date of final payment of the principal and to have such arrears of interest paid out of the corpus of the Trust Funds before any payments could be made to subordinate lienors? †

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* In the Fifth and Ninth Series there was an additional creditor. The Bank, which was the former Trustee, obtained, on payment of the surcharge recovered against it, liens of $85,825 and $88,124.98 on the Fifth and Ninth Series Trust Funds, respectively, which were subordinated to all bonds of the respective Series, including the subordinated bonds (R. 228), and thus had priority over the above mentioned class 3 creditors, namely, the other Series of bonds. In addition, the judgment against the Bank provided that if the bonds of either the Fifth or Ninth Series were "paid in full", the Bank could apply "for relief by way of repayment to it of any surplus remaining in the Trust Fund" (R. 228).

† Certain subsidiary questions relating to adjustment of funds between principal and income accounts were also involved in the Construction Proceeding, but these questions became moot by the decision of the Court of Appeals on the main question (*Eddy* v. *Prudence-Bonds Corporation*, 165 F. 2d 157).

To obtain a judicial determination of the question of construction, petitioner and City Bank Farmers Trust Company, the new Trustee for all Series, petitioned the reorganization court for instructions (R. 228-229, 234-235, 236-237).

The issue was referred to a Special Master who reported, in substance, that the bonds were income bonds on which interest was payable only to the extent earned on the collateral (R. 131).

Under the Master's Report, collateral in Surplus Series was to be used, first, to pay the principal of the subordinated bonds of the Series, and the balance then remaining was distributable *pro rata* among the public bondholders of the Deficit Series, with the exception that in the Fifth and Ninth Series the above mentioned subordinate liens of the Bank were to be paid first out of collateral remaining after payment of the principal of the subordinated bonds of said Series respectively (R. 131). To illustrate, the Fifth Series is a Surplus Series. After payment of the principal of the Fifth Series bonds there remained $360,610.22, which, under the Master's Report, was payable, 1) $67,200 in full payment of subordinated Fifth Series bonds, 2) $85,825 in full payment of the Bank's subordinate lien, and 3) $207,585.22 to the public bondholders of the Deficit Series *pro rata* (R. 665).

In the aggregate, under the Special Master's Report, the public bondholders of the Deficit Series would have received approximately $810,000 from the Surplus Series (R. 665).

The Master's Report was confirmed by the District Court (R. 237-239), and on an appeal prosecuted by Mr. Silbiger and Messrs. Weil, Gotshal & Manges the order of the District Court was reversed (*Eddy* v. *Prudence-Bonds Corporation*, 165 F. 2d 157), certiorari was denied (333 U. S. 845) and the Construction Proceeding was concluded in July, 1948 (R. 243).

Under the reversing order of the Court of Appeals (165 F. 2d 157), collateral remaining in principal account of

a Surplus Series is distributable on account of arrears of interest on the bonds of the Series at the original bond rate, with the result that neither the subordinated bondholder nor the Bank (as holder of a subordinate lien in the case of the Fifth and Ninth Series only), nor the public bondholders of the Deficit Series will receive any distributive share from the Surplus Series.

In the reorganization, Mr. Silbiger represented George E. Eddy, Katherine Born and Bessie B. Reilly (R. 248-249, 365, 368, 369, 513-522, 533, 543, 573-575). Mr. Eddy holds $16,000 of bonds of ten Series, $4,000 of which are of Surplus Series and $12,000 of Deficit Series (R. 248-249, 575, 665). Mrs. Born and Mrs. Reilly hold a total of $14,000 of bonds of three Series, all of which are Deficit Series (R. 249, 573-574, 665). The result successfully advocated by Mr. Silbiger in the Construction Proceeding was adverse to the financial interests of Mrs. Born and Mrs. Reilly, and to the financial interests of Mr. Eddy as holder of $12,000 of Deficit Series bonds. Under the order of the District Court, which Mr. Silbiger aided in reversing, the Deficit Series in which Mr. Eddy holds bonds would have received approximately $624,500 from the Surplus Series, and the Deficit Series in which Mrs. Born and Mrs. Reilly hold bonds would have received approximately $155,200 (R. 222-223, 248-249, 573-574, 665).

For his services in the Construction Proceeding, which were not extensive,* and the result of which adversely

* The Construction Proceeding involved, in substance, only three short hearings before the Master, one contested motion before the District Court, a consolidated appeal, a petition for rehearing and a petition for certiorari (R. 244-245). All papers prepared by Mr. Silbiger in all courts, exclusive of his briefs, totaled only 49 pages (R. 146-147). In his brief on the appeal in the proceeding Mr. Silbiger stated, "In the case at bar no dispute as to any facts ever arose * * *. The only issues presented are issues of law, involving the interpretation of the plans * * *" (R. 288-289). And in his brief in this court in opposition to the petition for certiorari, Mr. Silbiger stated, "No controversy of public interest or importance with respect to legal principles is involved" (R. 289).

affected the financial interests of two of his three individual clients and may have adversely affected his third client,* Mr. Silbiger requested an allowance of $459,500;† he was awarded $75,000 (R. 10, 158), which sum is subject to reduction under the decision of the Court below (R. 761).‡

Mr. Miller and Messrs. Weil, Gotshal & Manges appeared in the Construction Proceeding on behalf of two groups of individual bondholders (R. 326, 328, 352-353, 544-545, 546, 553-554, 611, 622). During the pendency of the reorganization the clients of these attorneys traded in Prudence bonds on a large scale. Mr. Miller's clients purchased $447,300 of the bonds and sold $244,300 of bonds; the clients of Messrs. Weil, Gotshal & Manges purchased $537,100 of bonds and sold $439,000 of bonds (R. 153-156, 616, 666-669, 708-711, see also R. 306-315). As the Court below said, "Miller's clients always held and traded in more bonds of 'Surplus Series' than 'Deficit Series'; Weil, Gotshal & Manges' clients' dealings were more in bonds of 'Deficit Series'" (R. 761). These attorneys, notwithstanding their clients dealt in bonds of most all Series, confined their activities in the Construction Proceeding to the Fifth Series (R. 326, 357, 609, 611). They said they never inquired whether their clients held bonds of other Series (R. 547, 553); and claimed they first learned of such fact

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* Mr. Silbiger testified in the proceeding to fix his allowance that he did not know "how the results (of the Construction Proceeding) affected the financial interests of Mr. Eddy", and that he never "made the calculation whether he was better off one way or another" (R. 467).

† Petitioner contended that the allowance requested by Mr. Silbiger "was so exorbitant as to shock the conscience of a court of equity" and justify denial of any allowance (R. 113, 114).

‡ Mr. Silbiger applied for leave to appeal his award of $75,000 and his application was denied; he attempted to appeal as of right and his appeal was dismissed. He then petitioned for certiorari to review the orders of the Court below and his petition was denied on April 24, 1950 (*Silbiger* v. *Prudence-Bonds Corporation*, No. 546, October Term, 1949).

when petitioner proved it at the hearings on the allowance applications (R. 553, 570-571).* They advocated in the Construction Proceeding the side of the Surplus Series. Mr. Miller, however, did not appeal and took no part in the appeal (R. 183-184, 263, 268, 331-332). Messrs. Weil, Gotshal & Manges applied for an allowance of $50,000 and were awarded $20,000; Mr. Miller applied for $16,500 and was awarded $10,000 (R. 10, 158). Their awards were affirmed by the Court below (R. 761).

The allowance applications were first passed upon by a Special Master, whose Report was modified by increasing by $5,000 the allowance to Messrs. Weil, Gotshal & Manges and as so modified confirmed (R. 10, 157, 318). Petitioner and Reconstruction Finance Corporation filed objections to the applications (R. 112, 148), and objections to the Master's Report (R. 189, 205, 276). Petitioner and RFC sought leave to appeal on several grounds (R. 13) and their application was granted limited to the questions of conflicts of interests (R. 7).

Specification of Errors to Be Urged

The Court below erred:

1. In holding that Samuel Silbiger, Esq. may be awarded an allowance notwithstanding its finding that he served two conflicting interests and opposed and was disloyal to one of the interests he represented.

2. In holding that a particular exception may be made to the "rule of undivided loyalty" in a case of an attorney who serves conflicting interests in a corporate reorganization under the Bankruptcy Act.

3. In holding that the "rule of undivided loyalty" has less force in a corporate reorganization under the Bankruptcy Act than it has in a suit *inter partes*.

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* They would have learned about their clients' holdings and dealings in the bonds if they had complied with Section 210 of the Bankruptcy Act.

4. In failing to hold that Mr. Silbiger should be denied any allowance.

5. In holding with regard to Mr. Miller and Messrs. Weil, Gotshal & Manges that the Bankruptcy Act authorizes the granting of an allowance to attorneys serving only the individual interests of speculators in the bonds of the corporation in reorganization.

6. In holding that the clients of Mr. Miller and Messrs. Weil, Gotshal & Manges are not parties to the instant proceeding to fix allowances, and in failing to hold that any right of subrogation against the said clients could be enforced by way of reduction of the allowances awarded to the said attorneys.

7. In failing to hold that Mr. Miller and Messrs. Weil, Gotshal & Manges should be denied any allowance.

Reasons for Granting the Writ

1. The decision of the Court below presents important questions of law involving the administration of the Bankruptcy Act and the obligations of an attorney to his clients in corporate reorganization cases.

2. The decision below with regard to Mr. Silbiger:

(a) Is a departure from established doctrine and is probably in substantial conflict with decisions of this Court and of other appellate courts, both State and Federal.

(b) The Court below determined that Mr. Silbiger represented conflicting interests and was disloyal to one of the interests and that he "must be denied any allowance whatever, unless there is a distinction between a corporate reorganization and an ordinary suit *inter partes*" (R. 760). The Court held there was such a distinction and that the penalty of Mr. Silbiger's disloyalty should be a

reduction of his allowance, rather than a denial of any allowance. The Court then said (R. 761):

> "* * * How far the penalty should be mitigated, we leave to the district court * * *. We will, however, say now—all the issues having been argued—that we should regard it as an abuse of discretion not to cut the allowance by at least one-third. * * * We do not wish to indicate that we think a cut of one-third is enough, * * *."

There is no yardstick to measure in dollars the amount by which an allowance should be reduced in a case of disloyalty of an attorney to a client; the suggested cut of at least one-third appears to be speculative and arbitrary. "Such a calculation of probabilities is beyond the science of the chancery" (Cardozo, C. J., in *Meinhard* v. *Salmon*, 249 N. Y. 458, 465). The Deficit Series clients whom Mr. Silbiger opposed and to whom he was disloyal would have received in excess of $667,000 under the order of the District Court in the Construction Proceeding which Mr. Silbiger appealed and aided in reversing on behalf of his Surplus Series clients. This Court, in *Woods* v. *City National Bank*, 312 U. S. 262, 268, said: "the incidence of a particular conflict of interest can seldom be measured" and the "bankruptcy court need not speculate" as to the effect or result of the conflict. This Court also said in the *Woods* case (p. 268), citing *American United Mutual Life Ins. Co.* v. *City of Avon Park*, 311 U. S. 138: "'reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act".

(c) The Court below, in holding that Mr. Silbiger may have an allowance, stated (R. 759-760):

> "* * * Certainly by the beginning of the Seventeenth Century it had become a common-place that an attorney must not represent opposed interests; and the usual consequence has been that he is debarred from receiving any fee from either, no matter how successful his labors * * *."

And then concluded by saying (R. 761):

> "* * * we recognize that we are departing from a doctrine that has been applied with great severity."

In departing from established doctrine, the Court below failed to follow the decision of this Court in the *Woods* case, *supra,* which requires "strict adherence" to the doctrine, particularly in corporate reorganization cases. In the *Woods* case, this Court cited and relied upon *Meinhard* v. *Salmon,* 249 N. Y. 458, 464, where Mr. Justice Cardozo (then Chief Judge) made his classic statement on the attitude of courts of equity when petitioned "to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions" and said the rule "will not consciously be lowered by any judgment of this Court".

Both this Court and the New York Court of Appeals recognized that one "particular exception" leads to another, and a seemingly good one usually to a bad one. The "particular exception" made by the Court below is that the rule is not applicable with full force in cases of lawyers who serve conflicting interests in corporate reorganizations under the Bankruptcy Act (R. 760).

The dangers inherent in making exceptions to the "rule of undivided loyalty" are indicated by the speculations indulged in to make the instant exception. The basis for the exception was that Mr. Silbiger's Deficit Series clients were represented in the Construction Proceeding by petitioner, Prudence-Bonds Corporation (R. 760); the inference being that they were, therefore, adequately represented and only partially injured by Mr. Silbiger's disloyalty. On the petition for rehearing, however, the pillar on which the exception stood fell; the Court below admitted it made a mistake of fact in saying that the Deficit Series were represented by petitioner, Prudence-Bonds Corporation (R. 785).* The Court then made a second choice. It

* Petitioner Prudence-Bonds Corporation represents all eighteen Series of bonds and at each stage of the Construction Proceeding made it clear that it could not and should not advocate for one group of its bondholders in opposition to the other (R. 775-778).

said the public bondholders of the Deficit Series were represented by Prudence Realization Corporation, the successor to the defaulting Guarantor and holder of the subordinated bonds of both Surplus and Deficit Series (R. 785, 212-213), and that if Mr. Silbiger had applied to the Court "to be freed of his duties to" the Deficit Series "it is at least doubtful whether * * * the judge would have thought it necessary that an attorney should be appointed in addition to him who represented the Prudence Realization Corporation" (R. 785). It is on this that the exception now stands.

If Mr. Silbiger had made such an application it is doubtful that the Judge would have granted it without appropriate consents of the three individuals who retained Mr. Silbiger and made it possible for him to be in the case. It is doubtful that the Judge would have granted it at all. If all facts had been brought out, the application might very well have been viewed with suspicion. Mr. Silbiger would have been seeking court authorization to advocate for a result which would adversely affect the financial interests of two of his individual clients and might adversely affect the financial interests of his third client.* Upon abandonment by Mr. Silbiger of the three bondholder clients through whom he derived a right to represent bondholders as a class, Mr. Silbiger would have been left without any client and would have had no standing to continue in the proceeding.

There is also substantial doubt whether the District Court Judge would have considered the public bondholders of the Deficit Series adequately represented by counsel for the subordinated bondholder. It is true that if the subordinated bondholder had succeeded in the posi-

* Mr. Silbiger's clients Mrs. Born and Mrs. Reilly held $14,000 of bonds all of Deficit Series, and of the $16,000 of bonds held by his client Mr. Eddy, $12,000 were of Deficit Series (R. 248-249, 573-575, 665). In the proceeding to fix allowances, Mr. Silbiger admitted Mr. Eddy may have lost money as a result of the contentions he advocated in the Construction Proceeding (R. 469).

tion it took in the Construction Proceeding the public bondholders of the Deficit Series would have benefited. But it is true also that the subordinated bondholder did not speak for and was not authorized to speak for the Deficit Series public bondholders. The result was that the appeal in the Construction Proceeding was briefed as if it presented only a contest between the public bondholders of *all* Series on one side and the subordinated bondholder (the defaulting Guarantor) on the other (R. 594). And it may have been decided on such an erroneous assumption. The Court below, by the three Judges who decided the instant appeal, said in their opinion on the Construction Proceeding appeal "We sustain the position of the Publicly Held Bonds", whereas, actually their decision was against all Deficit Series public bondholders who constitute the majority of all public bondholders (*Eddy* v. *Prudence-Bonds Corporation,* 165 F. 2d 157, 159, cert. denied, 333 U. S. 845). Then for the first time the subordinated bondholder undertook to speak for the Deficit Series public bondholders. It petitioned for rehearing and certiorari and urged that the Court had "Mistakenly assumed the controversy was between the Publicly-Held Bonds on the one side, and the Guarantor on the other" (R. 594-595). Its efforts at that point to aid itself by mentioning the rights of the Deficit Series public bondholders were futile and came much too late to be considered as constituting adequate representation of the Deficit Series.

The tenuous theory of the exception is, therefore, that if counsel for another party had won his case he would have incidentally won the case for the clients to whom Mr. Silbiger was disloyal. The theory is entirely speculative, it is wholly contrary to the basic reasons for the "rule of undivided loyalty". It would not be too great an extension to say that an attorney for two opposed parties in a litigation might have compensation from the winner to whom he adhered for the reason that the losing party, if he had been represented, would have lost the case anyway. Or to say that a broker guilty of disloyalty might neverthe-

less have his commission for the reason he obtained the best bargain for both buyer and seller. Or that a trustee, although disloyal, made a good bargain for his beneficiary.

All these and similar theories, however, have many times been rejected by the Courts when petitioned "to undermine the rule of undivided loyalty". The rule is grounded in broad principles of public policy, applicable with equal, if not more, force in corporate reorganizations where lawyers appear on behalf of classes composed of large numbers of security holders, most of whom have no contact with the lawyer (Cf. *Weil* v. *Neary*, 278 U. S. 160, 171). "The rule is indeed scrupulous and rigid" (*Presbyterian Church* v. *Plainfield Trust Co.*, 139 N. J. Eq. 501, 513). "The 'law does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed * * * without undertaking to deal with the question of abstract justice in the particular case'" (*Wendt* v. *Fisher*, 243 N. Y. 439, 443-444); "It prevents frauds by making them as far as may be impossible knowing that real motives often elude the most searching inquiry * * *. The value of the rule * * * lies to a great extent in its stubbornness and inflexibility" (*Munson et al.* v. *S. G. & C. R. R. Co.*, 103 N. Y. 58, 74). "The rule is designed to obliterate all divided loyalties which may creep into a fiduciary relationship and utterly to destroy their effect * * *" (*City Bank Farmers Trust Co.* v. *Cannon*, 291 N. Y. 125, 132).

(d) In lowering the "rule of undivided loyalty" and creating the instant "particular exception", the Court below followed its recent decision in *Berner* v. *Equitable Office Building*, 175 F. 2d 218 (R. 761), where it held that Berner might have an allowance on a reduced basis, notwithstanding a possible violation of Section 249 of the Bankruptcy Act by reason of Berner's activities in giving inside information to relatives who dealt in the stock of the company in reorganization. In the *Berner* case, in which the opinion of the Court was also by Judge Learned

Hand, the decision of this Court in the *Woods* case *supra*, was cited, but only in respect of a collateral question of burden of proof (175 F. 2d 220). The decision of the Court below in the instant case does not mention the *Woods* case, which is a corporate reorganization case.

The *Berner* case itself is probably in substantial conflict with the decision of the Third Circuit in *In re Midland United Co.*, 159 F. 2d 340, where the Court held that dealings in securities by the wife of a fiduciary will bar the fiduciary from receiving any compensation. In the *Berner* case, the Court, citing *In re Midland United Co.*, said (p. 221): "indeed, in some jurisdictions a purchase by a trustee's wife is *ipso facto* invalid".

The *Berner* case appears to be another "particular exception" made in disregard of the rule of the *Woods* case.* The instant exception is a substantial extension of the exception in the *Berner* case. In the instant case, the Court said that the loss of all compensation required by a violation of Section 249 of the Bankruptcy Act "is a far milder consequence than attends the breach of full-fledged fiduciary duties" (R. 764), but inconsistently held that although Mr. Silbiger breached the "high trust" relationship of attorney and client, the consequence should be merely a reduction of his allowance which is "far milder" than the consequence of a breach of Section 249.

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* In the *Berner* case, the Court below said "in any event the reduction (of Berner's allowance) may well be not less than the loss to the sellers of whom Bell bought the 20,000 shares" (175 F. 2d 222). After remand, the District Court made various calculations and then decided that Mr. Berner "should be awarded, in the absence of the Peter Bell episode, a fee of $100,000. For the part he played in that transaction it is my judgment he should be assessed a minimum of $30,000. If it be said that this amount is in excess of the sum that the loss which the Commission (SEC) estimated may have come to persons who supplied stock to Bell, the reply must be that the difference between $30,000 and $24,643.40, or $5,356.60, is far less I believe than was the cost to this estate of the litigation that grew out of the stock purchase that was made by Peter Bell. * * * When all is said and done, one fact is as plain as day and that is that petitioner (Berner) wrongfully enabled Peter Bell to make a possible profit of $24,643.40". (*In re Equitable Office Bldg. Corp.*, Opinion by Judge Knox, Jan. 10, 1950, not officially reported.)

Thus, in recent months the "particular exception" of the *Berner* case has influenced the same Court to make this still greater "particular exception" and both exceptions have been made in disregard of decisions of this Court and of the weight of authority. The soundness of the "rule of undivided loyalty" is beyond question; the principle that "no man shall serve two masters" has been considered a good one for over 1900 years. It has particular force to the relationship of attorney and client; it should have special force in bankruptcy cases. As Mr. Justice Brewer (then Circuit Judge) said in *United States* v. *Costen,* 38 Fed. 24:

> "Now it is to the glory of our profession that its fidelity to its client can be depended on; * * * I can tolerate many things a lawyer may do * * *, but I cannot tolerate for a moment, neither can the profession, neither can the community, any disloyalty on the part of a lawyer to his client."

(e) The conscious lowering of the rule and the creating of "particular exceptions" thereto by the Second Circuit Court of Appeals will tend to further erosion of the rule's solid foundation by virtue of the substantial influence of decisions of the learned Court below upon Federal District Courts and other Courts of Appeals. In this situation, this Court should exercise its power of supervision to maintain the vitality of its decisions and the integrity of a doctrine so sound, so deeply ingrained in the law, as to make departure therefrom intolerable to courts, the profession and the community.

3. The decision below with regard to Mr. Miller and Messrs. Weil, Gotshal & Manges also raises substantial questions of interpretation and administration of the Bankruptcy Act. These questions, we believe, have not been, but should be, decided by this Court.

(a) These attorneys acted solely for individual clients who bought and sold during the Construction Proceeding, in which they rendered their services, large blocks of the Debtor's bonds of both Surplus and Deficit Series classes;

they did not represent or purport to represent or owe any duty to either class. The interests of their clients were of a competing and shifting character, changing from time to time as they bought and sold bonds. The Bankruptcy Act, we submit, was not intended to authorize classes of security holders to be charged with the fees of attorneys employed to represent the individual interests of speculators in the securities in reorganization.

(b) The awards of allowances to Mr. Miller and Messrs. Weil, Gotshal & Manges do violence to and impair the effectiveness of the spirit and purpose, if not the letter of, Section 249 of the Bankruptcy Act. True these attorneys did not themselves trade in the bonds. The fact, however, that their clients did—and on a large scale—results in a situation where the attorneys' primary duty and loyalty was to clients whose interests were necessarily in conflict with the interests of the class which is to pay the awards. The underlying basis of Section 249, which denies all compensation to representatives of security holders who deal in the securities of the company in reorganization, "means neither more nor less than that a fiduciary may not serve conflicting interests" (*In re Midland United Co.*, 64 F. Supp. 399, 415, aff'd 159 F. 2d 340). If the clients of these attorneys had paid their fees and were now applying for reimbursement, Section 249 would require denial of their applications (*Young* v. *Potts*, 161 F. 2d 597, 600). The same rule should be applied to direct applications of their attorneys so as to place the burden of their compensation on the clients where it belongs. "The principle that a client should pay for services rendered applies in proceedings under Section 77B as well as in other fields of litigation" (*Teasdale* v. *Sefton Nat. Fibre Can Co.*, 85 F. 2d 379, 382).

(c) Implicit in the decisions of this Court in *Dickinson Industrial Site, Inc.* v. *Cowan*, 309 U. S. 382; *Brown* v. *Gerdes*, 321 U. S. 178; *Young* v. *Higbee Co.*, 324 U. S. 204, is the proposition that allowances should not be awarded payable by a class to those who serve individual interests and who are not bound to the class by fiduciary ties. It

is certainly implicit in these decisions that allowances should not be made payable by a class to attorneys who serve individual interests in conflict with the interests of the class. The equitable principle of charging allowances to a class goes back to the early case of *Trustees* v. *Greenough,* 105 U. S. 527, in which the suit was instituted for the benefit of all creditors and in which this Court said (p. 532), "if the complainant is not a trustee, he has at least acted the part of a trustee in relation to the common interest". Mr. Miller and Messrs. Weil, Gotshal & Manges represented and purported to represent only their clients, and while disclaiming any duty to the class, and notwithstanding that they did not act "the part of a trustee in relation to the common interest", claim their fee from the class. They indeed were driven to disclaim a duty to the class in avoidance of the consequence of serving conflicting interests, since the interests of their clients and those of the class were not the same. To grant allowances in such circumstances would tend to impair the effectiveness of Section 249. Individuals could appear in reorganizations, state at the outset they appear only for themselves, deal in the securities to their own advantage, and the attorneys for such individuals, and the individuals as well, could obtain allowances. Section 249 is not the "only arrow in the quiver of the bankruptcy court"; it "was intended to augment and not to limit the jurisdiction of the Bankruptcy court" (*In re Midland United Co., supra,* 159 F. 2d 344, 345).

CONCLUSION

Wherefore, it is respectfully submitted that this petition for certiorari should be granted.

Respectfully submitted,

CHARLES M. MCCARTY,
Counsel for Petitioner.

April 27, 1950.

APPENDIX

Bankruptcy Act, Sec. 210, 11 U. S. C. Sec. 610: An attorney for creditors or stockholders shall not be heard unless he has first filed with the court a statement setting forth the names and addresses of such creditors or stockholders, the nature and amounts of their claims or stock, and the time of acquisition thereof, except as to claims or stock alleged to have been acquired more than one year prior to the filing of the petition.

Bankruptcy Act, Sec. 249, 11 U. S. C. Sec. 649. Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceeding in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

INDEX

Page

Apepndix 13

CITATIONS

Cases:

American United Mutual Life Insurance Co. v. *City of Avon Park*, 311 U. S. 138 ..... 6, 7, 10

Berner v. *Equitable Office Building Corp.*, 175 F. 2d 218 10

Brooklyn Trust Co. v. *Kelby*, 134 F. 2d 105, certiorari denied, 319 U. S. 767 3

Brown v. *Gerdes*, 321 U. S. 178 6

Central Hanover B. & T. Co. v. *President and Directors of the Manhattan Co.*, 105 F. 2d 130 3

Cromwell v. *Curtis*, 99 F. 2d 810 10

Eddy v. *Kelby*, 163 F. 2d 56, certiorari denied, 332 U. S. 936 3

Eddy v. *Kelby*, certiorari denied, 319 U. S. 755 3

Eddy v. *Kelsey*, 148 F. 2d 323 3

Eddy v. *Prudence Bonds Corp.*, 165 F. 2d 157 4

Manufacturers Trust Co. v. *Kelby*, 125 F. 2d 650, certiorari denied, 316 U. S. 697 3

Meinhard v. *Salmon*, 249 N. Y. 458 8

Midland United Co., In re, 64 F. Supp. 399 ..... 10, 12

Midland United Co., In re, 159 F. 2d 340 6

Munson et al. v. *S. G. & C. R. R. Co., et al.*, 103 N. Y. 58 ..... 8, 10

Presbyterian Church v. *Plainfield Trust Co.*, 139 N. J. Eq. 501 ..... 8, 10

Prudence Bonds Corporation, In re, 57 F. Supp. 839, modified and affirmed, 147 F. 2d 465, certiorari denied, 324 U. S. 866 3

Prudence Bonds Corp., In re, 122 F. 2d 258 7

Prudence Bonds Corporation, In re, 76 F. Supp. 643 3

Republic Gas Corp., In re, 35 F. Supp. 300 7

Ritz Carlton Restaurant & Hotel Co., In re, 60 F. Supp. 861 ..... 6, 12

S. E. C. v. *United States Realty Improvement Co.*, 310 U. S. 434 ..... 8, 12

Silbiger v. *Prudence Bonds Corporation (New Corporation) and Reconstruction Finance Corporation, No.* 829 1

Weil v. *Neary*, 278 U. S. 160 ..... 6, 7, 8, 9, 10

Wendt v. *Fischer*, 243 N. Y. 439 ..... 8, 10

Woods v. *City Bank Co.*, 312 U. S. 262 ..... 6, 7, 8, 9, 12

Young v. *Higbee Co.*, 324 U. S. 204 ..... 6, 9

Young v. *Potts*, 161. F. 2d 697 ..... 6, 9

Statutes:

	Page
Bankruptcy Act, 30 Stat. 544, as amended, 11 U.S.C. 1 *et seq.*:	
Sec. 77(b)	2
Sec. 172	12
Sec. 206	2, 7, 13
Sec. 208	12
Sec. 243	2, 7, 13
Sec. 249	10

Miscellaneous:

63 Harv. L. Rev. 1056	10
Hearings on H. R. 6439 and H. R. 8046 (1938) before the Committee on the Judiciary, House of Representatives, 75th Cong., 1st sess., at pp. 163, 186	7
Restatement of Trusts, Sec. 243	10
S. E. C. Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part I, 236, *et seq.* (1937)	8
50 Yale L. J. 1492	10

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 785

PRUDENCE-BONDS CORPORATION (NEW CORPORATION), PETITIONER

v.

SAMUEL SILBIGER, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

This memorandum is submitted on behalf of the Reconstruction Finance Corporation, as an intervening party, and the Securities and Exchange Commission, as *amicus curiae*. Both of these agencies share identical views with regard to one of the principal questions in this case, namely, whether in a corporate reorganization an attorney who represents conflicting interests is barred from receiving

any fee from the estate, no matter how successful his labors.[1]

The court below has squarely held that an exception to the general rule barring compensation to an attorney who represents conflicting interests should be made in the case of corporate reorganizations, and that the bankruptcy court instead may diminish the fee otherwise payable by the estate which benefited from the services by taking into account the character of the conflicting representation. The opinion of the court below (R. 755) is reported at 180 F. 2d 917.

We submit that the decision below is erroneous; that it is in conflict with the decisions of this Court and of the Court of Appeals for the Third Circuit; and that the question is of such importance as to warrant certiorari. The relevant statutory provisions are Section 206 of the Bankruptcy Act (11 U.S.C. 606) and Section 243 (11 U.S.C. 643), which are set forth in the Appendix, *infra*, p. 13.

The essential facts can be briefly stated. Sometime in 1934, Silbiger was employed by George E. Eddy, Mrs. Katherine Born and Mrs. Bessie B.

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[1] This is the question presented by the Silbiger allowance involved in No. 785. Silbiger has filed a cross-petition for certiorari. *Silbiger* v. *Prudence-Bonds Corporation (New Corporation) and Reconstruction Finance Corporation*, No. 829. There is a second question in No. 785, whether the allowances to Miller and to Weil, Gotshal and Manges are barred because their clients traded in securities of the debtor (Pet. 19-21). While we think the opinion of the court below goes too far in suggesting that attorneys' allowances are not at all affected by their clients' trading activities, we express no opinion as to the necessity for review of this second question.

Reilly, each of whom held a number of bonds in different series issued by the debtor, to represent them in the reorganization proceedings of the Prudence-Bonds Corporation under Section 77(b) of the Bankruptcy Act. Up to 1945, Silbiger represented the common interest of each of these clients in phases of the reorganization proceeding which led to the confirmation of a plan of reorganization in 1938, and in supplemental proceedings involving an accounting by the indenture trustees.[2] Silbiger was compensated from the estate for these services, receiving a total of $70,000 (R. 210).

In 1945, however, a proceeding arose to construe certain provisions of the reorganization plan in order to determine the relative rights of the various series of bonds to the collateral securing the bonds. At this point, the interests of the different series were opposed to each other. There were 18 different series of bonds outstanding, each backed by a separate block of collateral (R. 212). In some instances, the collateral was more than enough to meet the principal amount of the bonds that it secured, and the question in the construction pro-

[2] *Central Hanover B. & T. Co.* v. *President and Directors of the Manhattan Co.*, 105 F. 2d 130; *Manufacturers Trust Co.* v. *Kelby*, 125 F. 2d 650, certiorari denied, 316 U.S. 697; *Brooklyn Trust Co.* v. *Kelby*, 134 F. 2d 105, certiorari denied, 319 U.S. 767; *In re Prudence Bonds Corp.*, 57 F. Supp. 839, modified and affirmed, 147 F. 2d 465, certiorari denied, 324 U.S. 866; *Eddy* v. *Kelsey*, 148 F. 2d 323; *In re Prudence-Bonds Corporation*, 76 F. Supp. 643; see also *Eddy* v. *Kelby*, certiorari denied, 319 U.S. 755, and *Eddy* v. *Kelby*, 163 F. 2d 56, certiorari denied, 332 U.S. 836, relating to allowances in the accounting proceedings.

ceedings was whether the excess over that amount should be applied against the interest owing on these bonds or should go to certain other claimants, including holders of series of bonds without sufficient collateral to meet even the face amount (R. 131). For convenience, the series of bonds having collateral in excess of their principal amounts have been described as surplus series and the others as deficit series.

Silbiger's clients held primarily deficit series bonds. All of the bonds held by Mrs. Born and Mrs. Reilly were in that category, while Eddy held some bonds of the deficit series and some of the surplus series (R. 248-249). Notwithstanding the fact that the financial interests of some of his clients lay completely on the side of the deficit series, Silbiger took the position in the construction proceedings that the excess collateral behind the surplus series should go entirely to the holders of surplus series bonds to apply on their interest claims (R. 32). Silbiger and others successfully prosecuted an appeal from a contrary holding of the master and the district court.[3] In consequence of these efforts, excess collateral that would otherwise have been turned over to Silbiger's clients holding deficit series bonds was ordered to be paid instead to the holders of the surplus series bonds. For his serv-

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[3] *Eddy* v. *Prudence Bonds Corp.*, 165 F. 2d 157. The master and the district court had held that the excess collateral should be applied first to pay certain subordinated debt, with the remainder going to the deficit series.

ices in the contest among the various classes of bondholders in these construction proceedings, the district court awarded Silbiger a fee of $75,000 (R. 10).

On appeal from this award by the New Corporation and the Reconstruction Finance Corporation, the court below found that, even taking Silbiger's version of the facts as true, Silbiger had not properly severed his connection with the deficit series clients, that he continued in the fiduciary relationship of attorney not only to his particular clients but to all other holders of bonds in the deficit series; and that he was therefore serving conflicting interests (R. 757-759). The attorney, not the client, it held, has the responsibility for ascertaining and avoiding any representation of conflicting interests.

The court below conceded that if this were "an ordinary suit *inter partes*" the rule would apply that an attorney who represents opposing interests is debarred from receiving any fee from either, no matter how successful his labors; and that Silbiger would not be permitted to show whether the conflict of his loyalties had in fact influenced his conduct and, if so, to what extent (R. 760). However, the court decided that an exception from this rule should be made in a corporate reorganization where it can be shown that the evil of conflicting representation is mitigated because "the client [prejudiced by the attorney's divided allegiance] is other-

wise adequately protected, and the attorney is not paid in any part by the party whose side he has opposed" (R. 760). Finding these conditions present in the case at bar, despite the representation of conflicting interests, the court directed that Silbiger be allowed a fee provided it was reduced by at least one third of the amount awarded by the district court (R. 761).

The decision of the court below, allowing a fee to an attorney who represented conflicting interests in a corporate reorganization, is in direct conflict with *Woods* v. *City Bank Co.*, 312 U. S. 262, where this Court, refusing to inquire whether the representation of conflicting interests was in fact prejudicial to either client, denied compensation to attorneys and other fiduciaries who represented the conflicting interests of the mortgagee and equity owners in a Chapter X reorganization proceeding. The *Woods* decision was approved in *Brown* v. *Gerdes*, 321 U. S. 178, 182; it was followed by the Third Circuit in *In re Midland United Co.*, 159 F. 2d 340. See also *In re Ritz Carlton Restaurant & Hotel Co.*, 60 F. Supp. 861, 866-867 (D. N.J.). In making an exception to the strict requirement of "loyal and disinterested service" by fiduciaries as a condition to their compensation, the court below has undermined a fundamental policy of bankruptcy proceedings established by this Court not only in the *Woods* case but in *American United Mutual Life Insurance Co.* v. *City of Avon Park*, 311 U. S. 138; *Weil* v. *Neary*, 278 U. S. 160, 173;

and *Young* v. *Higbee Co.*, 324 U. S. 204. See also *Young* v. *Potts*, 161 F. 2d 597 (C.A. 6).[4]

No basis for an exception is found either in the language or the policy of the Bankruptcy Act. Section 243 of the Act (Appendix, *infra*, p. 13) authorizes the allowance of "reasonable compensation for services rendered"; and this phrase "necessarily implies loyal and disinterested service," *Woods* v. *City Bank Co.*, 312 U. S. at 268. The purpose of Section 206 of the Act (11 U.S.C. 606, *infra*, p. 13), which gives individual security holders a right to participate through counsel directly in the proceedings, and Section 243, *supra*, which authorizes compensation to them and their representatives from the estate, is to assure individuals the right to be heard through representatives who do not serve conflicting interests.[5] The decision below frustrates this Congressional policy. In view of the fact that Section 206 permits any security holder to be represented in the proceedings, it is not difficult for an attorney so inclined to find a client he might nominally repre-

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[4] That the instant case is a 77B proceeding is of no significance. The allowances to attorneys in this case are governed by the provisions of Chapter X of the Chandler Act. *In re Prudence Bonds Corp.*, 122 F. 2d 258, 260. In any case, the rule requiring loyal and disinterested service in the interest of the persons whom the attorney purports to represent applies to 77B proceedings and to all other types of bankruptcy proceedings. *American Ins. Co.* v. *Avon Park, supra; Weil* v. *Neary, supra; In re Republic Gas Corp.*, 35 F. Supp. 300 (S.D. N.Y.).

[5] See Hearings on H. R. 6439 and H. R. 8046 (1938) before the Committee on the Judiciary, House of Representatives, 75th Cong., 1st sess., at pp. 163, 186.

sent in almost any case. If the law permits attorneys, as the proceeding progresses, to desert their clients and shift to whatever they think will be the winning side on each point of litigation, where their chances of a substantial fee might be better, the "interests of investors tend to become secondary; the interests of lawyers, primary."[6] We do not suggest that this evil is present in the case at bar, but the decision does encourage the "tendency to evil in other cases." *Weil* v. *Neary,* 278 U. S. 160, 173. Indeed, the nature of corporate reorganization proceedings is such that, rather than affording room for relaxing exceptions from the standards applicable to an *inter partes* relationship, it requires, as this Court has held, the application of the highest standards of fiduciary conduct. *Woods* v. *City Bank Co., supra; S.E.C.* v. *United States Realty Improvement Co.,* 310 U. S. 434, 455.[7]

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[6] See S.E.C. Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part I, 236, *et seq.,* (1937), where it was pointed out that in the absence of judicial scrutiny over counsel fees this situation was apparently of frequent occurrence in reorganizations, since the reorganization afforded "counsel great opportunity for entrepreneurial activity." The impression gained was "that reorganizations are frequently designed for the benefit of lawyers."

[7] There is no reason why attorneys in corporate reorganizations should practice in a less exacting climate than corporate directors, *Munson et al.* v. *S. G. & C. R. R. Co., et al.,* 103 N.Y. 58; commercial joint adventurers, *Meinhard* v. *Salmon,* 249 N.Y. 458; testamentary trustees, *Presbyterian Church* v. *Plainfield Trust Co.,* 139 N.J. Eq. 501; real estate brokers, *Wendt* v. *Fischer,* 243 N.Y. 439; to list only a few of the different types of fiduciaries who have been held to strict standards.

Contrary to the theory of the court below, there is nothing about corporate reorganization proceedings that enables the court to measure the effect of conflicting representation by looking to see whether the prejudiced clients were otherwise adequately represented. In the case at bar, the court could not be sure exactly who was "otherwise adequately" representing the interests of the deficit series, nominally but not actually represented by Silbiger.[8] Its reliance upon the fact that Silbiger's fee comes out of the clients whom his services benefited, not those he abandoned, fails to take into account the fact that their attorney, arguing for the opposing side of the case, successfully appealed from a decision in their favor and the abandoned clients lost benefits out of which they might willingly have paid fees. Cf. *Young* v. *Higbee Co., supra; Young* v. *Potts, supra.* Indeed, the impossibility of measuring the effect of representation of conflicting interests, manifest in the case at bar, proves the wisdom of the rule that no

[8] The court below originally suggested that their interests had been represented by the "New Corporation" (R. 760) but on rehearing the court stated it made a mistake and suggested that their interests were represented by "Prudence Realization Corporation" (R. 785). However, Prudence Realization Corporation did not speak for the public holders of deficit series, but for the corporate subordinated bondholders whose interests happened to coincide on one aspect of the issue in the Construction Proceedings with the public bondholders of deficit series, who were directly represented by Silbiger. See Pet. pp. 15-16. It is accordingly doubtful whether, if Silbiger had disclosed his representation of conflicting interests, the district court would have permitted him to proceed to represent one and drop the other. In any event, *Weil* v. *Neary, supra,* holds that such speculation is inadmissible.

inquiry should be made into whether representation of conflicting interests in fact harmed either client to any degree, or whether it resulted in fraud or unfairness. *Woods* v. *City Bank Co.*, 312 U. S. at 268; *American United Mutual Life Insurance Co.* v. *City of Avon Park*, 311 U. S. 138, 147; *Weil* v. *Neary*, 278 U. S. 160, 173; see, *Munson* v. *S. G. & C. R. R. Co.*, 103 N. Y. 58, 74; *Wendt* v. *Fischer*, 243 N. Y. 439, 443-444; *Presbyterian Church* v. *Plainfield Trust Co.*, 139 N. J. Eq. 501, 513.[9]

The prior decision by the court below in *Berner* v. *Equitable Office Building Corp.*, 175 F. 2d 218, offers no aid to the decision in the case at bar. The *Berner* decision is plainly erroneous, if it is deemed to hold that the rule against representation of conflicting interests does not apply to corporate reorganizations,[10] or that the effects of such representation can be mitigated by the extent of the injuries suffered by either client.[11]

The question in this case is of great importance in the administration of the bankruptcy and cor-

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[9] The absolute prohibition of the rule also avoids any reflection upon the integrity of the attorney involved, who may violate the rule inadvertently "without the slightest moral blame or stigma." *In re Midland United Co.*, 64 F. Supp. 399, 406 (D. Del.).

[10] In *Cromwell* v. *Curtis*, 99 F. 2d 810, the Second Circuit appeared to hold that the rule did not apply to corporate reorganizations, but this decision was virtually overruled by the *Woods* decision. 50 Yale L. J. 1492, 1494-1495.

[11] The court in the *Berner* case treated the facts as involving not a case of representing conflicting interests, nor as one under Section 249 of the Bankruptcy Act, but as one involving a breach of fiduciary duty which did not completely bar compensation to the trustee, citing Restatement of Trusts, Sec. 243. See 63 Harv. L. Rev. 1056.

porate reorganization statutes. It is a major policy of Chapter X of the Chandler Act to make certain that representatives of a class of security holders are not subject to the influence of conflicting interests.[12] The enforcement of the rule barring an allowance to fiduciaries who represent conflicting interests in corporate reorganizations cannot safely be left to the clients directly involved. As the court below held, this is a professional responsibility of the attorneys that cannot be intrusted exclusively to the judgment of clients. The Reconstruction Finance Corporation, a party to the appeal below, has an interest in preventing a violation of this rule in the case at bar, since any allowances to the attorneys will come out of funds which might otherwise go to it.[13]

The Securities and Exchange Commission, al-

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[12] See footnote 5, *supra*.

[13] RFC has a participation as a creditor, of approximately 16% in the assets of Prudence Realization Corporation, successor to The Prudence Company, Inc., guarantor of the Debtor's bonds. Among said assets which are being liquidated solely for the benefit of the creditors of The Prudence Company, Inc., are unsubordinated or publicly held bonds in various Series of original principal amount of $396,500 (R. 672).

Prudence Realization Corporation also holds subordinated bonds in unpaid original principal amount of $1,873,000, including bonds of $105,700 original principal amount in the Ninth Series, which has been charged (R. 11) with $24,704.84, approximately 24% of the allowances awarded in the district court. Since the order of the district court, the publicly held bonds in the Ninth Series have been paid in full with interest at the original rates. Accordingly, any allowances payable from the Ninth Series will not be paid from money which would otherwise be paid on account of subordinated bonds in the Ninth Series held by Prudence Realization Corporation.

though not a party to the proceedings below, has an interest which extends beyond this particular case, for it is charged with seeing to it that the appropriate standards of equity and fiduciary responsibility prevail in corporate reorganizations. See Sections 172 and 208 of the Bankruptcy Act (11 U.S.C. 572, 608); *S. E. C.* v. *U. S. Realty Co.*, 310 U.S. 434, 458-460; *In re Ritz Carlton Restaurant & Hotel Co.*, 60 F. Supp. 861; *In re Midland United Co.*, 64 F. Supp. 399, 403.

A decision in the case at bar will necessarily be a guide to the disposition of similar problems in other corporate reorganizations. The decision below clouds the clear rule of the Court in the *Woods* case; hence, if unreviewed, even if not followed in other Circuits, it will create confusion as to the applicable rule to be followed by the courts in the Second Circuit, which have jurisdiction over many important bankruptcy reorganizations. Accordingly, because of the conflict of decisions presented, and because of the importance of the question involved, it is urged that the petition for certiorari be granted.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

JUNE 1950.

APPENDIX

Bankruptcy Act, 30 Stat. 544, as amended by the Act of June 22, 1938, 52 Stat. 883, 11 U.S.C. 606, 643:

Section 206:

> The debtor, the indenture trustees, and any creditor or stockholder of the debtor shall have the right to be heard on all matters arising in a proceeding under this chapter. The judge may, for cause shown, permit a labor union or employees' association, representative of employees of the debtor, to be heard on the economic soundness of the plan affecting the interests of the employees.

Section 243:

> The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred by creditors and stockholders, and the attorneys for any of them, in connection with the submission by them of suggestions for a plan or of proposals in the form of plans, or in connection with objections by them to the confirmation of a plan, or in connection with the administration of the estate. In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto.

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